BASICS OF MUTUAL FUND

Different investment avenues are available to investors. Mutual funds also offer good investment opportunities to the investors. Like all investments, they also carry certain risks. The investors should compare the risks and expected returns after adjustment of tax on various instruments while taking investment decisions. The investors may seek advice from experts while making investment decisions.

With an objective to make the investors aware of functioning of mutual funds, an attempt has been made to provide information in question-answer format which may help the investors in taking investment decisions.

BEGINNER:

1) What is a Mutual Fund?

Mutual fund is a mechanism for pooling money by issuing units to the investors and investing investors funds in securities in accordance with objectives as disclosed in offer document. Investments in securities are spread across a wide cross-section of industries and sectors and thus the risk is diversified because all stocks may not move in the same direction in the same proportion at the same time. Mutual funds issue units to the investors in accordance with quantum of money invested by them. Investors of mutual funds are known as unitholders. The profits or losses are shared by investors in proportion to their investments. Mutual funds normally come out with a number of schemes which are launched from time to time with different investment objectives. A mutual fund is required to be registered with Securities and Exchange Board of India (SEBI) before it can collect funds from the public.

2) What is the history of Mutual Funds in India and role of SEBI in mutual funds industry?

Unit Trust of India was the first mutual fund set up in India in the year 1963. In late 1980s, Government allowed public sector banks and institutions to set up mutual funds. In the year 1992, Securities and Exchange Board of India (SEBI) Act was passed. The objectives of SEBI are to protect the interest of investors in securities and to promote the development of and to regulate the securities market. As far as mutual funds are concerned, SEBI formulates policies, regulates and supervises mutual funds with an aim to protect the interest of the investors. SEBI notified the regulations for mutual funds in 1993. Thereafter, mutual funds sponsored by private sector entities were allowed to enter the capital market. The regulations were fully revised in 1996 and have been amended thereafter from time to time. SEBI also issues directions through circulars to mutual funds from time to time to protect the interests of investors. All mutual funds whether promoted by public sector or private sector entities, including those promoted by foreign entities are governed by the same set of Regulations. There is no distinction in regulatory requirements for these mutual funds and all are subject to monitoring and inspections by SEBI.

3) How is a mutual fund set up?

A mutual fund is set up in the form of a trust, which has sponsor, trustees, Asset Management Company (AMC) and custodian. The trust is established by a sponsor or more than one sponsor who is like promoter of a company. The trustees of the mutual fund hold its property for the benefit of the unitholders. AMC approved by SEBI manages the funds by making investments in various types of securities. Custodian, who is required to be registered with SEBI, holds the securities of various schemes of the fund in its custody. The trustees are vested with the general power of supervision and direction over AMC. They monitor the performance and compliance of SEBI Regulations by the mutual fund. SEBI Regulations require that at least two-thirds of the directors of trustee company or board of trustees must be independent i.e. they should not be associated with the sponsors. Also, 50% of the directors of AMC must be independent. All mutual funds are required to be registered with SEBI before they launch any scheme.

INTERMEDIATE:

Benefits of Investment

Diversification - Spreads risk across numerous financial investments. Asset allocation - Allows for a selection of an optimised mix of assets.

Investments help you achieve your long-term financial goals by allowing your money to grow. They help you to combat the impact of inflation (an upward movement in the average levels of price) on your saved money.

The rate of inflation is important, as it represents the rate at which the real value of investments are eroded, and the loss in spending power over time. Inflation also indicates exactly how much returns (in percentage terms) your investments need to make for you to maintain a certain standard of living. Thus, investments help you to use your money productively. They enable you to meet rising expenses over time. Some of the benefits of planned investments are as follows:

- **Diversification**

Diversification spreads the risk across numerous financial investments. It reduces the impact of poor returns from any one investment say for instance mutual fund in the overall portfolio. The prices of shares, bonds, listed property and other investments often do not rise and fall in tandem. When one type of investment is on the rise, another may be on the decline. The end result is that your portfolio's overall performance is likely to be less volatile when it is diversified.

- **Asset Allocation**

Asset allocation is an investment strategy that aims at balancing risk and reward by selecting an optimised mix of assets according to an individual's goals, risk tolerance and investment tenure. All asset classes may not perform well during the chosen time frame. Therefore, having investment spread in different asset classes in a suitable mix, enhances the chances of an overall good performance of the portfolio.

EXPERT:

- Mutual Fund schemes are generally classified into 2 types viz.

  A) Schemes according to Maturity Period:

- **Open-ended Fund/ Scheme**

An open-ended fund or scheme is one that is available for subscription and repurchase on a continuous basis.

- **Close-ended Fund/ Scheme**

  A close-ended fund or scheme has a stipulated maturity period e.g. 5-7 years. The fund is open for subscription only during a specified period at the time of launch of the scheme. Investors can invest in the scheme at the time of the initial public issue and thereafter they can buy or sell the units of the scheme on the stock exchanges where the units are listed. In order to provide an exit route to the investors, some close-ended funds give an option of selling back the units to the mutual fund through periodic repurchase at NAV related prices.

- **B) Schemes according to Investment Objective:**

  A scheme can also be classified as growth scheme, income scheme, or balanced scheme considering its investment objective. Such schemes may be open-ended or close-ended schemes as described earlier. Such schemes may be classified mainly as follows:

- **Growth / Equity Oriented Scheme**

  The aim of growth funds is to provide capital appreciation over the medium to long- term. Such schemes normally invest a major part of their corpus in equities. Such funds have comparatively high risks. These schemes provide different options to the investors like dividend option, capital appreciation, etc. and the investors may choose an option depending on their preferences. The investors must indicate the option in the application form. The mutual funds also allow the investors to change the options at a later date. Growth schemes are good for investors having a long-term outlook seeking appreciation over a period of time.

- **Income / Debt Oriented Scheme**

  The aim of income funds is to provide regular and steady income to investors. Such schemes generally invest in fixed income securities such as bonds, corporate debentures, Government securities and money market instruments. Such funds are less risky compared to equity schemes. These funds are not affected because of fluctuations in equity markets. However, opportunities of capital appreciation are also limited in such funds. The NAVs of such funds are affected because of change in interest rates in the country. If the interest rates fall, NAVs of such funds are likely to increase in the short run and vice versa. However, long term investors may not bother about these fluctuations.

- **Balanced Fund**

The aim of balanced funds is to provide both growth and regular income as such schemes invest both in equities and fixed income securities in the proportion indicated in their offer documents. These are appropriate for investors looking for moderate growth. They generally invest 40-60% in equity and debt instruments. These funds are also affected because of fluctuations in share prices in the stock markets. However, NAVs of such funds are likely to be less volatile compared to pure equity funds.

- **Money Market or Liquid Fund**

These funds are also income funds and their aim is to provide easy liquidity, preservation of capital and moderate income. These schemes invest exclusively in safer short-term instruments such as treasury bills, certificates of deposit, commercial paper and inter-bank call money, government securities, etc. Returns on these schemes fluctuate much less compared to other funds. These funds are appropriate for corporate and individual investors as a means to park their surplus funds for short periods.

- **Gilt Fund**

These funds invest exclusively in government securities. Government securities have no default risk. NAVs of these schemes also fluctuate due to change in interest rates and other economic factors as is the case with income or debt oriented schemes.

- **Index Funds**

Index Funds replicate the portfolio of a particular index such as the BSE Sensitive index, S&P NSE 50 index (Nifty), etc These schemes invest in the securities in the same weightage comprising of an index. NAVs of such schemes would rise or fall in accordance with the rise or fall in the index, though not exactly by the same percentage due to some factors known as "tracking error" in technical terms. Necessary disclosures in this regard are made in the offer document of the mutual fund scheme. There are also exchange traded index funds launched by the mutual funds which are traded on the stock exchanges.

- **Sector specific funds/schemes**

These are the funds/schemes which invest in the securities of only those sectors or industries as specified in the offer documents. e.g. Pharmaceuticals, Software, Fast Moving Consumer Goods (FMCG), Petroleum stocks, etc. The returns in these funds are dependent on the performance of the respective sectors/industries. While these funds may give higher returns, they are more risky compared to diversified funds. Investors need to keep a watch on the performance

of those sectors/industries and must exit at an appropriate time. They may also seek advice of an expert.

- **Tax Saving Schemes**

  These schemes offer tax rebates to the investors under specific provisions of the Income Tax Act, 1961 as the Government offers tax incentives for investment in specified avenues. e.g. Equity Linked Savings Schemes (ELSS). Pension schemes launched by the mutual funds also offer tax benefits. These schemes are growth oriented and invest pre-dominantly in equities. Their growth opportunities and risks associated are like any equity-oriented scheme.

What is systematic investment plans (SIPs)
Investors will have the opportunity to plan their further investments and withdrawals from the scheme via the SIP/SWP. They can invest or withdraw regularly, at a specific frequency (subject to the other provisions of the schemes) thus benefiting from the economics of average cost of purchase and sale.

What is a Systematic Withdrawal Plan?
SWP is a facility given to the Unit holders to withdraw amounts from the Scheme on periodic basis by giving a single instruction. In a SWP the investors can redeem a fixed sum/ number of units- minimum 50 units and multiples thereof at specified intervals. An investor has to have a minimum balance of specified no. of units or specified amount at all times The default SWP date will be 2nd of every month (in case it falls on a non-business day, the transaction will be effected on the next business day of the Scheme). The SWP frequency is monthly. The Load Structure prevailing at the time of submission of the SIP/STP/SWP application will apply for all the installments indicated in such application.

What are your rights as an investor? What resource do you have to your grievances?

a) Unitholders under the scheme have a proportionate right in the beneficial ownership of the assets of the mutual fund under the scheme.

b) The unitholders have a right to ask the trustee company/board of trustees about any information which may have an adverse bearing on their investments, and the trustees shall be bound to disclose such information to the unitholders.

c) The appointment of the Asset Management Company in respect of this scheme may be terminated by a majority of Trustees or 75% of the unitholders.

d) Units of the scheme are generally non-transferable. However, transfer of units, in cases outlined under the heading Transferability/ Transmission of units and subject to conditions stated therein, shall be made within 30 days from the date of lodgment.

e) Warrants in respect of dividends, if declared, will be dispatched to the unitholders within 30 days of the declaration of dividend if any.

f) Redemption or repurchase warrants will be dispatched within 10 working days from the date of their receipt of request duly complete in all respects by the appropriate Office.

g) The Trustees may, from time to time, add to or otherwise amend or alter all or any of the terms of this scheme, for duly complying with the guidelines of Government, RBI/SEBI or any other regulatory body or in the interest or convenience of the Fund or the unit holders. and any modification of the fundamental attributes of the scheme, or the trust or the fees and expenses payable or any other modification by the Trustees shall be made bearing in mind that the interest of the unit holders is not affected and no change in any of the above shall be carried out unless –

A written communication about the change is sent to each unit holder and an advertisement is given in one English daily newspaper having nation-wide circulation as well as in a newspaper published in the language of the region where the Head office of the Mutual Fund is situated; and

The unit holders are given an option to exit at prevailing NAV without any exit load.
h) An Abridged scheme wise annual report shall be mailed to all unitholders not later than 6 months from the date of closure of the relevant accounting year and the full annual report shall be available for inspection at the corporate office of Mutual Fund and a copy shall be made available the unitholders on request on payment of nominal fees, if any.

DOCUMENTS FOR INSPECTION:

The following documents will be available for inspection to the unit holders at the corporate office of the Mutual Fund:

1. The Trust Deed

2. Memorandum of Association of Asset Management Company

4. Articles of Association of Asset Management Company

5. Investment Management Agreement

6. Custodial Agreement

7. Registrars Agreement (as and when they are appointed)

8. Audited Balance Sheet of the Mutual Fund

10. Offer Document of the scheme.

For detailed guidelines - SEBI Investors Education Programme – Investments in Mutual Funds